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RUEHBR/AMEMBASSY BRASILIA 6171
RUEHLP/AMEMBASSY LA PAZ 2924
RUEHPE/AMEMBASSY LIMA 1204
RUEHSP/AMEMBASSY PORT OF SPAIN 3751
RUEHQT/AMEMBASSY QUITO 3018
RUEHSG/AMEMBASSY SANTIAGO 4148
RUEHDG/AMEMBASSY SANTO DOMINGO 0676
RHEHNSC/NSC WASHDC
RHEHAAA/WHITEHOUSE WASHDC
RHEBAAA/DEPT OF ENERGY
RUCPDOC/DEPT OF COMMERCE
RUEATRS/DEPT OF TREASURY
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C O N F I D E N T I A L SECTION 01 OF 02 CARACAS 001056

SIPDIS

ENERGY FOR ALOCKWOOD AND LEINSTEIN, DOE/EIA FOR MCLINE
HQ SOUTHCOM ALSO FOR POLAD
TREASURY FOR MKACZMAREK
COMMERCE FOR 4332/MAC/WH/JLAO
NSC FOR RKING

E.O. 12958: DECL: 08/04/2019
TAGS: EPET EINV ENRG ECON CU VE
SUBJECT: VENEZUELA: FACTORS THAT INFLUENCE CRUDE OIL PRODUCTION

REF: A. CARACAS 817

Classified By: Economic Counselor Darnall Steuart, for reasons 1.4 (b) and (d).

¶1. (C) SUMMARY. Many factors likely affect Venezuela crude oil production levels and production capacity, including recent oil service sector expropriations, challenges in securing foreign exchange authorizations, increased crude inventory levels, implementation of the joint venture (JV) model, and decreased activity levels. END SUMMARY.

¶2. (C) From June 2 through 15, Petroleum Attache (PetAtt) and visiting Washington energy analyst met with industry representatives in Zulia, Caracas, and Monagas. This is a complementary cable to Reftel A and septel covering production in Western Venezuela. A final cable in this series will examine opportunities to increase production easily and describe the possible future business opportunities that compel the international service companies to seek to find a way to remain in Venezuela.

Factors that Negatively Impact Production

¶3. (C) PDVSA'S LACK OF TECHNICAL EXPERTISE: Dave Beacham, the General Manager of Simco (strictly protect throughout), told PetAtt on July 2, that of the 18 injection platforms Simco operated prior to being expropriated in early 2009, six were now offline due to PDVSA's inability to service and maintain them. In addition, one of two water treatment plants that Simco operated was offline. Williams Venezuela Country Manager Teresa Palacios (strictly protect throughout) confirmed to EmbOffs that two trains at Williams, expropriated PIGAP II facility were offline due to technical failures. While PDVSA might have some capacity to operate machinery, it appears increasingly doubtful that it has the ability to maintain and repair some key equipment.

¶4. (C) EXPROPRIATIONS: Post has separately reported on the expropriations of Wood Group's SIMCO operations, Williams' Wilpro subsidiary, and the nearly 80 confiscations of marina service companies on Lake Maracaibo. In addition to these seizures, PDVSA's expropriation of U.S. firm Exterran represents a significant wildcard in Venezuela's future production possibilities. In addition to being a minority partner SIMCO and Wilpro, Exterran separately operated and maintained 214 units (compressors, gas turbines, power generators, and gas process plants) scattered throughout PDVSA fields (including in Maracaibo, Apure, Anaco, El Tigre, Monagas, and CoroCoro). It provided power generation for three separate oil fields. Exterran officials indicated that its operations supported crude production in the La Conception field of 300,000 b/d, in CoroCoro of 33,000 b/d, and in Guafita of 50,000 b/d. The Ministry of Energy and Petroleum (MENPET) has not issued the formal expropriation resolution for Exterran's Venezuelan assets. PDVSA has not shown that it has a plan to meet the challenge of absorbing Exterran's geographically and technologically diverse operations.

¶5. (C) FOREIGN EXCHANGE AND CADIVI: Several local Venezuelan oil sector equipment manufacturers shared that they no longer receive U.S. dollar authorizations from Venezuela,s currency control board (CADIVI) for imported materials. They have been forced to move operations to the parallel market (effectively tripling import costs) just to remain in business. In order to manage costs, they have cut staff and reduced operations (some have moved from three to one shift

per day). Decreased local production of oil sector equipment, such as drill bits and electric submersible pumps, could have an impact on crude production as oil companies are forced to look to other markets to procure products that had been available locally. PDVSA,s inability to pay arrears directly affects the oil services manufacturing companies' financial health. In order to weather the current situation, many manufacturers are financing operations through local bank loans (at an average interest rate above 20%). Several international service companies, such as Baker Hughes, have established Venezuela as a regional manufacturing hub over the years. Difficulties with foreign exchange affects their ability to import supplies and export products within the region and thus, to support their operations in other countries.

¶6. (C) CRUDE INVENTORIES: According to Chevron officials (strictly protect) PetroBoscan has a storage capacity of 7 million barrels and currently had 6 million barrels in storage. Chevron speculated that PDVSA oil traders might be having difficulty selling the heavy crude on the international market due to global market conditions. (NOTE: While PDVSA might be stockpiling crude oil in the hopes that prices will increase, we believe it would use other storage facilities. If PetroBoscan's storage reached capacity, PDVSA would be forced either to shut off wells as the crude oil would have no place to go or to sell at discounted rates.)

¶7. (C) THE JOINT-VENTURE MODEL: PDVSA's majority control over the JVs is an on-going challenge to its minority partners. The implementation of the JV model has increased inefficiencies and operating costs. Chevron officials confirmed that PetroBoscan cancelled a $2 million equipment order from a U.S. contractor for specially manufactured equipment for a necessary maintenance upgrade. The Chevron officials agreed that PetroBoscan would eventually have to buy that equipment out of inventory and would pay a significantly higher price for having delayed the acquisition. Staff increases under the JV model have raised signicantly operating costs. Prior to the migration into a mixed company in 2007, Chevron operated the PetroBoscan fields with 230 employees. Since the launch of the mixed company, employment has ballooned to 1,100. An oil services sector executive shared that PetroPiar, the PDVSA-Chevron

extra heavy oil joint venture in the East, grew from 600 employees to over 2,000 with the 2007 migration to a joint venture.

¶8. (C) DECREASED ACTIVITY LEVELS: Commenting on the efficiency of PDVSA's own Exploration & Production (E&P) division, Chevron officials shared that E&P "lost" (it most likely ruptured) a 40,000 b/d pipeline in Lake Maracaibo in May. In 2008, E&P operated 60 rigs in the area and was only operating 30 now. Finally, PDVSA was shutting in wells because it could not handle the water cut (the raw liquid flow from the wells that includes crude oil, sand, water, and condensates) in its land facilities, thus reducing production capacity.

¶9. (C) COMMENT. Discerning the future direction of Venezuelan crude oil production requires consideration of numerous factors. To date, none of the GBRV's actions would demonstrate that PDVSA will be able to increase production in the near future. Lacking any change in direction, we expect production will continue to decrease. The pending question remains, whether any one of these factors could accelerate the rate of decline (e.g. such as PDVSA's inability to maintain electricity production in the oil fields).
DUDDY